

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 99-0128 ST
Sales and Use Tax
For The Tax Periods: 1993 through 1997**

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ISSUES

I. Use Tax – Manufacturing Exemption: Fork-lifts

Authority: 45 IAC 2.2-5-8

Taxpayer protests amount of use tax assessed on its purchase and rental of fork-lifts.

II. Use Tax – Manufacturing Exemption: Scissor lift

Authority: IC 6-8.1-5-1(b); 45 IAC 2.2-5-8

Taxpayer protests use tax assessed on its purchase of a scissor lift.

III. Use Tax – Manufacturing Exemption: Hoist

Authority: 45 IAC 2.2-5-8

Taxpayer protests the amount of use tax assessed on its purchase of a hoist.

IV. Use Tax – Manufacturing Exemption: Shrink-wrap machine

Authority: 45 IC 6-2.5-5-3; 45 IAC 2.2-5-8

Taxpayer protests use tax assessed on its purchase of a shrink-wrap machine.

V. Use Tax: Environmental Control Equipment

Authority: IC 6-2.5-5-30

Taxpayer protests the amount of use tax assessed on its purchase of environmental control equipment.

VI. Use Tax: Steel Detailing

Authority: 45 IAC 2.2-4-2; Maurer v. Indiana Dept. of Revenue, 607 N.E.2d 985, 987 (Ind. Tax Ct. 1993).

Taxpayer protests use tax assessed on its purchase of steel detailing.

VII Negligence Penalty: Imposition

Authority: IC 6-8.1-10-2.1

Taxpayer protests the Department's imposition of a 10% negligence penalty.

STATEMENT OF FACTS

Taxpayer is a manufacturer of thermal insulation. Taxpayer's products include ceramic fiber blankets, insulation boards, and ceramic papers and ropes. Its products are used by, among others, automobile manufacturers, ceramic and glass manufacturers, aerospace industries. During the audit period taxpayer purchased numerous items tax-exempt. Taxpayer now protests the proposed assessment of use tax on these items.

I. Use Tax – Manufacturing Exemption: Fork-lifts

DISCUSSION

Taxpayer protests use tax assessed on its purchase and rental of fork-lifts. Taxpayer argues that these fork-lifts are wholly or partially exempt from tax because they are used to transport work-in-process. The Department regulations provide the following illustrations:

- (1) A forklift is used exclusively to move work-in-process from a temporary storage area in a plant and to transport it to a production machine for processing. Because the forklift functions as an integral part of the integrated system comprising the production operations, it is exempt.
- (2) A forklift is used exclusively to move finished goods from a storage warehouse and to load them on trucks for shipment to customers. The forklift is taxable because it is used outside the integrated production process.
- (3) A forklift is regularly used 40% of the time for the purpose described in Example (1) and 60% of the time for the purpose described in Example (2). The taxpayer is entitled to an exemption equal to 40% of the gross retail income attributable to the transaction in which the forklift was purchased.

45 IAC 2.2-5-8. Audit explained in the audit report that certain forklifts were used for shipping and warehousing and that certain fork-lifts were used for exempt purposes. Whole or partial

credit was given for use tax paid upon that portion of forklift use determined to be exempt while assessments were made to the extent that the forklifts were used for non-exempt purposes. Thus, the Department finds that audit correctly determined the taxability of taxpayer's forklifts.

FINDING

Taxpayer's protest is denied.

II. Use Tax – Manufacturing Exemption: Scissor lift

DISCUSSION

Taxpayer protests use tax assessed on its scissor lift. Taxpayer states the "scissor lifts hold the pallets that the bags of insulation are stacked on prior to final packaging." Taxpayer argues that since the production process includes "packaging, if required," the scissor lift is used directly in the direct production because it is within that process. 45 IAC 2.2-5-8(d).

Taxpayer has failed to meet its burden of demonstrating that the scissor lift equipment comes within the exemption provided under 45 IAC 2.2-5-8. There is no substantive evidence which shows this equipment is involved in the "direct production, manufacture, fabrication, assembly" or has an "immediate effect" on taxpayer's insulation products. 45 IAC 2.2-5-8(a), (c).

Taxpayer's vague assertion that the equipment is involved in the final packaging of the insulation is insufficient. IC 6-8.1-5-1(b) places the burden of proving that auditor's assessment is wrong on the "person against whom proposed assessment is made."

FINDING

Taxpayer's protest is denied.

III. Use Tax – Manufacturing Exemption: Hoist

DISCUSSION

Taxpayer protests the assessment of use tax on a hoist. In order for manufacturing equipment to be exempt from the gross retail and use tax, the equipment must be purchased for direct use in the production process and must have an immediate effect on the article being produced. 45 IAC 2.2-5-8(c). Property has an immediate effect on the article being produced if the property is an essential and integral part of an integrated process that produces tangible personal property. Id.

As one step in taxpayer's production process, taxpayer uses a laminating machine to attach a continuous paper backing unto one side of its insulation products whereby the paper backing becomes an integral part of the finished product. In conjunction with the laminating machine, a hoist-like device is used to lift and place into position rolls of paper intended to be used as paper backing. When the original hoist proved inadequate, taxpayer purchased a replacement. It is this replacement which is the subject of taxpayer's protest.

Although the laminating machine itself is exempt from the gross sales and use tax under 45 IAC 2.2-5-8(c), the replacement hoist is not. The laminating machine is exempt because it has an immediate effect on taxpayer's insulation product and because it is an "essential and integral part of [the] integrated process which produces tangible personal property." *Id.* The replacement hoist is not exempt because it is one step removed from that integrated process and because it does not have an immediate effect on the taxpayer's finished products. The example provided at 45 IAC 2.2-5-8(c)(4)(G) is illustrative. The example states that "[e]quipment used to remove raw materials from storage prior to introduction into the production process . . ." is not exempt because it does not have "an essential and integral relationship with the integrated production system . . ." *Id.*

FINDING

Taxpayer's protest is denied.

IV. Use Tax – Manufacturing Exemption: Shrink-wrap machine

DISCUSSION

Taxpayer protests the assessment of use tax on the purchase of a shrink-wrap machine. Taxpayer argues that this equipment should be exempt from tax under IC 6-2.5-5-3 because the equipment is used in the direct production of taxpayer's insulating products.

At the final stage of taxpayer's production process taxpayer has produced forty-pound bundles of bulk insulating material. Each bundle is placed into plastic bags, weighed, x-rayed, and then positioned on a pallet. It is at this point that the pallet, loaded with the forty-pound bundles of bulk insulating material, is shrink wrapped. Taxpayer maintains that its customers require that the insulating materials be shrink wrapped, that the shrink wrapping protects the product during shipping, that the shrink wrapping serves to "enclose" the product, and that the shrink wrapping protects the product from contaminants.

The direct production of tangible personal property "ends at the point that the production has altered the item to its completed form, including packaging, if required." 45 IAC 2.2-5-8(d). Taxpayer's production process ends before the insulating product is shrink wrapped. By the time the bundles of packaged insulating material are stacked on the shipping pallet and are ready to be shrink wrapped, the product has reached the final marketable form in which the product will be received by taxpayer's customers. The shrink wrapping, although unquestionably aiding in the distribution of the product, does not constitute a production activity but is, instead, a post-production activity outside the scope of production. Therefore the shrink-wrap machine is taxable.

FINDING

Taxpayer's protest is denied.

V. Use Tax: Environmental Control Equipment

DISCUSSION

Taxpayer protests use tax assessed on its purchase of environmental control equipment. Audit exempted the structure of taxpayer's environmental control equipment. However, tax was assessed on bulk bags that are used in the pollution control equipment. Taxpayer explains that the bags filter the air and are essential to the functioning of the pollution control equipment.

Sales of tangible personal property are exempt from the state gross retail tax if: (1) the property constitutes, is incorporated into, or is consumed in the operation of device, facility, or structure predominantly used and acquired for the purpose of complying with any state, local, or federal environmental quality statutes, regulations, or standards; and (2) the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture. IC 6-2.5-5-30.

The bulk bags are used to filter the air and are essential to the functioning of taxpayer's pollution control equipment. Therefore, the Department finds that the bulk bags used in the pollution control equipment are not subject to tax.

FINDING

Taxpayer's protest is sustained.

VI. Use Tax: Steel Detailing

DISCUSSION

Taxpayer protests the assessment of use tax on its acquisition of "steel detailing" services. "Steel detailing" is a term-of-art employed by steel framing engineers. As used in this context, "steel detailing" refers to the pre-construction preparation of the designs, engineering, and specifications for the steel framing used in the construction of taxpayer's engineered metal buildings. As such, it is analogous to the work an architect would perform in designing and determining the technical specifications of a non-engineered building.

Professional services with respect to property not owned by the person rendering those services are not categorized as selling at retail and, therefore, not subject to the gross retail tax. IAC 2.2-4-2. Necessarily, the taxpayer's completed purchase of the "steel detailing" was evidenced by the transfer of the results of the service provider's design work in a tangible form. Taxpayer describes this tangible form as "specifications." In such circumstances the regulation provides that "[w]here, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

- (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from personal property;
- (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
- (3) The price charged for tangible personal property is inconsequential (not to exceed 10%) compared with the service charge; and
- (4) The serviceman pays gross retail or use tax upon the tangible personal property at the time of acquisition.”

45 IAC 2.2-4-2. Taxpayer’s purchase of “steel detailing” is exempt from the gross retail tax under 45 IAC 2.2-4-2. Taxpayer’s service provider is in the business of providing design specifications. The cost of the specifications is inconsequential when compared to the cost of the design work. The specifications - at least in their tangible form – are used as an incident to the provision of the steel detailing services. Taxpayer was indifferent as to the form or manner in which the results of the service provider’s work were transferred since the object of taxpayer’s purchase was the “steel detailing” not the incidental means by which that work was transferred. Moreover, in Indiana, it is the substance not the form of the transaction which determines the transaction’s tax consequences. Maurer v. Indiana Dept. of Revenue, 607 N.E.2d 985, 987 (Ind. Tax Ct. 1993).

FINDING

Taxpayer’s protest is sustained.

VII. Negligence Penalty: Imposition

DISCUSSION

Pursuant to IC 6-8.1-10-2.1, taxpayer was assessed a negligence penalty for failure to remit use tax to the Department. Taxpayer argues that this deficiency was due to reasonable cause. The taxpayer took prudent care in establishing a use tax accrual system to self-assess tax on taxable purchases. This effort, among other factors, demonstrates that the taxpayer exercised ordinary business care and prudence in carrying out its duty to remit use tax on its taxable purchases

FINDING

Taxpayer’s protest is sustained.